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Competitive Challenges for Belarus and Russia: the Study of Trade Effects and Economic Policy Implications of EU Eastward Enlargement

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Introduction

Europe's political boundaries are being redrawn by the enlargement of the European Union (EU) and the extension of the North Atlantic Treaty Organisation (NATO), while the continent's industrial fabric is being rewoven by myriad decisions about investment and trade. From the Barents to the Black Sea, with the membership of Poland, Hungary and Baltic States in the European Union (EU), Belarus, Ukraine and the Russian Federation will have common borders with the enlarged group of interdependent European economies. All of these former USSR republics are neither complete nation-states nor consolidated constitutional states with modern administration and rights to democratic participation. Moreover, they have taken very different paths of modernisation and systemic reforms, and, as a consequence developed divorced and hybrid forms of political and economic systems, marked by instability and a potential for socio-economic crises, which can cause conflicts in the future. This 'neighbourhood' between the future EU and non-members raises the questions about the new patterns of co-operation. This project is an attempt to find an answer to this question. It states that the global drive towards intensified integration in all sectors of human life and subsequent modernisation and 'Europeanisation' of East-Central European societies alter the prospect for semi-autarkic actions.

Eastward enlargement, which will result in the gradual incorporation of the former socialist countries into the EU structures, has arguably one of the most striking developments in European integration over the last decade. For the candidate countries, this has coincided with socio-political transformation within their national borders as well as a deepening of European integration. Despite its importance in a global context, one of the most direct impacts of such differential widening of European integration with subsequent increase in heterogeneity will be on the immediate neighbours of the EU. Given the outlook for catching-up process and for integration, the EU faces the prospect of having to deal with considerable disparities between member states' income levels and for a long time period.

The size of integration arrangement, the stability orientation of its policy framework and the global economic integration will imply that such grouping will play a significant role beyond its formal political borders. In other words, there is question of implications within borders and beyond them. While the various aspects of enlargement have been documented elsewhere, until now only partial and fragmented analyses of the implications of Eastward enlargement for individual non-accession countries or groupings of countries have been presented. This research is aimed at remedying this gap in academic research and offering a comprehensive policy report on the problematique raised. More specifically, my contribution addresses the following questions:

- To what extent the EU eastward enlargement might influence non-accession countries and what are the major channels of this influence?
- To what extent are the developments and transitions in the accession and non-accession countries riddled with tensions, antagonisms and contradictions?
- Could both the EU policies and national policies of the non-accession countries contain the seeds of efficiency that may sustain progress and development at the continent as a

whole? What kinds of policy innovations may be required for dealing with the challenges of EU enlargement?

It has still to decide whether Europe will be unified industrially, or a superior core will be surrounded by belts of small, segmented and underdeveloped markets and industries, of which Central and Eastern Europe will occupy the outer rings, because of such are the formative powers of competition. It is almost a cliché for politicians both in Belarus and Russia to focus on the NATO enlargement and to point out that there are adverse security implications of this process. At the same time, EU enlargement is seen as relatively neutral process, which will not lead any serious threat to internal security. In contrast, this paper tries to take economic aspects as the basic point of reference. It is argued that for the study of implications of EU Eastward enlargement to evolve into a coherent research program, it is important that scholars study the impact of enlargement on foreign trade regimes, economic structures and institutional machinery, representing multiple levels, particularly the country and the sectoral levels.

Conceptual apparatus

The paper employs an interdisciplinary methodological scheme, bringing together various approaches and setting the guidelines for the subsequent empirical investigation. It is hardly possible to grasp with key implications of enlargement from a single theoretical standpoint. Inter-disciplinary approach enables a richer and deeper understanding of the problematique raised. The central assumption is that the polity and the economy are inextricably inter-linked in any understanding of the performance of an economy. On the basis of such insight, what is being known as a political economy discipline, it is possible to clarify the divergent paths of transformation in the region and put the dynamics of integration and its implications into a more theoretical perspective.

Conventional economic theory equips us, among others, with two basic tools of analysis of economic integration. The first one is the gravity model, which includes three broad determinants that explain the size and the direction of bilateral trade flows (Bergstrand, 1985; Bikker, 1987). The determinants refer to the importer's demand, the exporter's supply and the cost, either with respect to transport or information, associated with foreign trade. Empirically, these factors are usually approximated by variables such as income and population of the trading partners, the geographical distance between, or, alternatively, government policies implemented. The use of this model helps us to examine the possibility of formation of a free trade area between non-associated countries and an enlarged Union. A pioneering inquiry was made by Gros and Steinherr (1995), who recommend the creation of a free trade zone between the EU and Russia, Belarus, and Ukraine.

It seems possible to use the gravitational model in two cases. First, to estimate export shares of Russia and Belarus, which accounts for the EU. The contribution lies in the estimation of the hypothetical, or counterfactual trade flows had the integration not taken place (*anti-monde*, the structure of that would generate the data in the same period in the absence of such an agreement). It is argued that EU enlargement will shift the 'economic core' of the EU towards the East so the trade flows will be redirected towards the immediate neighbours, such as Poland, Ukraine and the Baltics, which constitute the ‘natural trading region’. In such a region, countries are in close proximity to each other and natural trading costs are equal to zero.

The second important tool of economic analysis is a simple general equilibrium model. Static general equilibrium models are used extensively in applied economics to analyse government policies, often incorporating various specific conditions, such as increasing returns to scale, imperfect competition, and differentiated products (Shoven & Whalley, 1992; Francois & Reinert, 1997). In the context of ‘natural trading region’, it seems possible to use a general equilibrium model originally developed by Riezman (1985). The solution of this model can show that the establishment of a free trade area between the EU and Russia could be mutually beneficial for both partners. Moreover, this model stresses the interaction among different industries of an economy what allows to capture the impact of reallocating resources across various sectors. Thereby, epistemological potential of the model also lies in more rigorous quantification of allocation effects as well as identification of costs and benefits, or losers and winners under a policy change. It is a set of institutional constraints defines the relationships between different actors and therefore determines the way a politico-economic system works.

In turn, it is argued that institutions are the key determinants of the long-run performance of economies. Economic and political models are specific to particular constellations of institutional constraints that vary across space and cross sectionally in different economies (North, 1990). Institutions provide the basic structure by which human beings throughout the history have created the order and attempted to reduce uncertainty in exchange. Together with the technology employed, institutions determine transaction and transformation costs and hence profitability and feasibility of engaging in economic activity. A self-conscious awareness of these constraints is essential both for improved theory construction and for the issues of public policy. What creates efficient institutions?

While addressing the role of institutions, including the state, we need to know what defines its activity. In this case, the analytical focus is directed towards the analysis of class and social conditions that allow and enable the state to function in a certain way, and, therefore, produce economic outcomes. Critical political economy recognises the power relations, special interests, and arbitrariness contained in market forces and civil-societal relations, and relates these to state power (analysed in terms of historically specific ‘state/civil society complexes’, or ‘historic blocs’) (Cox, 1987).

The efficacy and relevance of state's interference calls into question the reform strategy, adopted by government. The dynamics of reform and international economic integration both in Russia and Belarus could be traced to a particular configuration of social forces, which are conditioned by hierarchically ordered configuration of social relations of production, and in turn condition such agencies as the form of state and its institutional machinery. In the course of transition, the success in advancing economic reforms could be seen to depend upon the ability of these agencies to mediate or suppress the demands of pivotal social and industrial actors. This can serve as an explanatory variable for Russia and most evidently in Belarus, where both stabilisation and structural reforms have stalled and even the basic design of the political and economic institutions is still fuzzy.

Another useful approach is a constructivist analysis, which looks at subjective mental constructs of the actors involved. The subjective perceptions of the actors are not crucially derived from but are continually being modified by experience that is filtered through existing (culturally determined) mental contacts. 'Ideas and ideologies matter and institutions play in determining just how they matter. Ideas and ideologies shape subjective mental constructs that individuals use to interpret the world around them and make choices' (North, 1990). They come from the cultural transformation of values, from the extension and application of formal rules to solve specific exchange problems, from the solution to straightforward co-ordination problems. In this connotation political economy could be viewed as 'identity-influencing', as a matrix of institutions, forces and practices within which people struggle against identities foisted on them; within which various actors struggle both to create identities that can be effective in their everyday lives, and to sort through the conflicting identities presented to them by the complexities of political-economic practices (Rosow, 1994). 'Identities are not given, but reconstituted through complex, historical overlapping (often contradictory) practices – and, therefore, variable, unstable and constantly changing' (Knutsen, 1997: 281-282, quoted in Rosamond, 2000). This places constructivism in a particular position in the debates about agency and structure.

Critical political economy explains a historical structure as a particular configuration between ideas, institutions and material forces. It is a framework of action, which constitutes the context of habits, pressures expectations and constraints within which actions take place, but which do not determine actions in any direct mechanical way (Cox, 1995). Agents are bound up by structures, but they are also capable through action of altering the structural environment in which they operate, albeit in ways that may be structurally constrained. The social agency requires a structural framework – being created through structural change, which includes national modernisation in combination with international integration – to act and perform a critical mass of its action. Critical realist approach holds that 'the structure and agency logically entail one another – a social or political structure only exists by virtue of the constraints on, or opportunities for, agency that it effects' (Hay, 1995: 189). In other words, structures do not determine the outcomes directly; rather they define the range of options and strategies pursued by actors within the process. Therefore, it is possible to identify layers of structure, which condition agency and which define the range of potential strategies that might be deployed by agents (whether individual or collective) in attempting to realise their intentions. Structures are both enabling (seen as resources) and constraining; they define the range of potential strategies and opportunities available to actors. Thus, social construction is the process by which social agents; social structure and shared meanings are constituted, resulting always in a form of social rule involving a form of domination.

The dynamics of internationalisation

This section provides a brief review of the current state of economic integration between the European Union and countries in transition (CIT) and then hypothesises on the main factors, which shape the integration process. According to conventional economic theory, integration occurs through foreign trade and foreign direct investments (FDI). Simple observation of the data on these two principle elements of economic integration allows us to categorise CIT according the degree of their integration with the EU.

On the basis of the data below, one can distinguish between three tiers of countries.

Table 1: Export (EXP) and import (IMP) shares of post-socialist countries, per cent

Year	1992		1993		1995		1998		1991-1998	
Country	EXP	IMP	EXP	IMP	EXP	IMP	EXP	IMP	EXP	IMP
Belarus	1.3	0.9	0.7	1.4	1.1	1.3	0.7	1.4	0.9	1.3
Bulgaria	4.4	5.5	3.2	4.4	3.7	3	2.7	2.3	3.5	3.8
Czech Republic	17.5	20.1	18.8	16.3	17.1	18.6	21.4	17.2	19.7	18
Hungary	25.6	22	14.7	15.6	14.9	13.8	22.2	14.1	19.3	16.8
Moldova		0.1	0.1	0.2	0.2	0.2	0.1	0.3	0.1	0.2
Poland	31.7	31.5	29	28.1	29.5	29.1	23.8	30.8	29.6	30.8
Romania	5.9	8.9	6	6.8	8.1	6.4	6.8	7	6.9	7.2
Slovak Republic	5.8	5.7	4.8	4.5	5.9	5.4	7.4	7.1	5.9	5.4
Ukraine	3.1	3.6	3.3	4.6	3.2	4.5	3.2	4.4	2.6	4

Source: Liargovas & Chionis, 2000: 59-60

The first includes countries with an annual share of exports and imports in total Central and East European (CEE) exports or imports above 10 per cent. These are the Czech Republic, Hungary and Poland. Taken together, these CIT – the fist tier – accounted for 68.8 per cent of total CEE exports to the EU and for 65.5 per cent of total CEE imports form the EU over the period 1991-1998. The second tier includes countries with an annual share of exports raging between 3 and 10 per cent. For imports the corresponding change is 4-10 per cent. The Slovak Republic, Bulgaria and Romania are in this group. Taken together these Central and East European countries (CEECs) accounted for 27 per cent of total exports to the EU and for 27.4 per cent of total imports from the EU over the period of 1991-1998 (on average). Finally, members of the CIS constitute the third tier. These are the countries for which an annual share of exports (imports) is below 3 per cent (4 per cent). This group includes Belarus, Moldova and Ukraine. Taken together these CIT accounted for 4.5 per cent of total exports to the EU and for 7.1 per cent of total imports over the period 1991-1998 (on average).

Besides trade, FDI is also an important factor of economic integration with the EU, on the one hand, and of economic development and transformation on the other. In countries which receive a relatively high inflow of FDI, enterprises with foreign participation account for an over-proportionate amount of export (and import) and investment activity (see Hunya, 1997). As a part of transition process, all CEECs have opened up their economies to FDI, albeit in varying degrees. They saw FDI as a key factor in restructuring and transformation process, albeit in varying degrees. The data support the same categorisation of CEECs as before.

Table 2: Foreign direct investment in Eastern Europe and the former Soviet Union, 1998

Region/Country	Cumulative FDI ($m)[a]	Cumulative FDI per capita ($)
Eastern Europe	53,162	481
Bulgaria	1,092	131
Czech Republic	10,383	1,010
Hungary	17,397	1,720
Poland	14,922	385
Romania	4,040	180
Slovakia	1,438	267
Baltic states	4,929	653
Estonia	1,550	1,085
Latvia	1,671	689
Lithuania	1,708	462
European CIS	19,751	93
Belarus	423	41
Moldova	274	63
Russian Federation	16,311	111
Ukraine	2,742	54

[a] From 1988
Source: ECE (1999), p.170

The fast movers are countries with an annual share of total FDI inflows above 15 per cent. Taken together these CIT accounted for around 77 per cent of total FDI inflows over the period 1991-1998 (on average). The second tier countries are those with an annual share of inflows raging between 2 per cent and 10 per cent. Taken together, these CEECs accounted for 20.9 per cent of total FDI inflows. The last tier is formed of countries with an annual share of FDI inflows below 2 per cent. Taken together, they accounted for 2.3 per cent of total FDI inflows over the period 1991-1998 (on average).

These observations allow us to generalise about three distinct sub-regional integration patterns that are emerging among selected transition economies:

1. *Tier 1*: 'Sustained restructuring': The Czech republic, Hungary, Poland and to some extent Slovakia have engaged in substantial restructuring, while others are much less advanced on the path of reform and have much less articulated trade and production networks with the EU.

2. *Tier 2*: 'Slow restructuring': Intermediate group, consisting of the 'second-wave' countries, such as the Slovak Republic, Romania and Bulgaria. These countries have made a step towards the integration with the EU, but still lagging behind in terms of internal restructuring of their economies.

Countries in these two groups are committed themselves to the EU membership and already integrated, albeit in varying degrees, in the EU structures. In other words, the enlargement of the EU is not the same as the economic integration of West and East. European enlargement is a structured, formal process. Those who will join the EU gain more than just easier access to the larger and more sophisticated Western market. They also win an imperative and anchor for reforms of the state structures and legal systems required providing stable adjustable rules and a sufficiently neutral administration capable of umpiring a capitalist economy. In contrast, the former Soviet republics have not expressed such commitment. They comprise a third tier of transition economies.

3. *Tier 3*: 'Delayed development' in the former Soviet Union (fSU) republics. Russia, Belarus, Moldova and Ukraine are the late developers, or slow reformers. These newly independent countries (NICs are all the members of the Commonwealth of Independent States (CIS), basically characterised by slow very modest success on a way to market reforms. All these countries retain considerable cross-border and enterprise links inherited from the Soviet era.
Why various CIT demonstrate such divergence in the progress? Summarising voluminous literature on the subject, it is argued that the national variations in basic strategies for privatisation, stabilisation, price and trade liberalisation, and industrial growth constitute 'implicit development strategies' that account for different market outcomes, including patterns of attachment to the West. As a result, there are divergent patterns of export and production specialisation among the CEECs (Liargovas & Chionis, 2001).

EU enlargement and its implications

- ✍ Trade aspects of EU enlargement

The current process of EU enlargement is a particularly striking example of the re-emergence of strong trade and production linkages between two groups of economies. But this process is characterised by a degree of complexity and heterogeneity. There are two forces that have been operating alongside each other in the course of enlargement. On the one hand, there is the accentuation of patterns of inter-industry specialisation, following the strong liberalisation of trade. Evidence on wage rates, labour productivities, and labour unit costs show a dramatic increase in the range of productivity levels, compensation rates per employee and in labour unit costs across the European continent as a result of east-west European economic integration. The liberalisation of external relations after 1989 has led to trade re-orientation and a rapid build-up of pressures towards a new pattern of specialisation in accordance with global market pressures, mostly in conformity with predictions made by traditional Heckscher-Ohlin trade theory.

On the other hand, the beginning of a process of catching up (much differentiated across the different CEECs) has been recorded, which is traditionally associated with a decline in intra-industry trade (Landesmann, 1995; 1998). In fact, there is a danger in applying standard trade theory in too simplistic manner to the situation of increasing trade and corporate links between CEECs and the EU. Trade in part results from the reconstruction of production systems and foreign investment helps to finance them. Evidence on catching up suggests the emergence of strong heterogeneity across the CEE economies. Fore some of them, notably Hungary and the Czech Republic, we observe strong increases in intra-industry trade with EU trading partners and a decline in the strong comparative bias against skill-, R&D- and, lately, capital-intensive branches.

Initially, in CEE's trade with the West there was observed an accentuation of specialisation towards labour-intensive branches and a decline of capital-intensive branches because of strong deficits in skill- and technology-intensive branches and a decline of capital-intensive branches. Consequently, discussion of East-West trade had focused on outward-processing traffic (OPT) arrangements – the exports of a single usually labour-intensive portion of transnational corporations' (TNC) internal supply networks and a simple version of vertical intra-industry trade – which were, in fact, often a step towards complex, capital-intensive production networks. By now, the empirical evidence suggests that ongoing organisational experimentation is underway, generating networks in Europe that go beyond OPT arrangements. Zysman and Schwartz characterise the current state of economic integration in the following manner:

'The review of empirical evidence on the ongoing CEE trajectory of trade and industrial development shows that CEECs have reached a turning point between an initial pattern of low-cost, low-value-added outward processing trade with Western Europe and a more sophisticated and more promising developmental model based on complementary reorganisation of production in an increasingly integrated regional economy' (Zysman and Schwarz, 1998).

This pattern of the extension of the EU towards the East, with the corresponding expansion of the Single Market is a prospect for the various industrialists within such lobbying groups as the European Roundtable of Industrialists (ERT), and the Union of Industrial and Employers' Confederations of Europe (UNICE). Both the ERT and UNICE lobbied vigorously for the speedy enlargement of the EU toward the East-Central Europe, insisting on structural adjustment and harmonisation procedures prior to accession. Both lobby groups insist the East-Central European countries undergo structural adjustment prior to accession, while national economic policies must be harmonised with those set by the European Union, and the markets must be fully opened to Western goods, services and investments. Hence, 'governments are expected to relinquish control over their economies' (Balanya et al., 2000: 65). These business groups' wish to see a harmonised market and liberalised investment regime for the whole of the European continent.

✍ Trade effects of enlargement

Probably the main channel of transmission through which EU enlargement will affect economic conditions in the non-associated countries runs via these countries' international trade relations with the EU area. It is argued that the impact of EU expansion on non-accession countries will depend crucially on the share of these countries' trade with both the EU and accession countries in their total external trade, and on the trade elasticity of these countries' economic growth. In other words, the similarity, or degree of overlap, in the trade structures of such countries as Russia and Belarus, exporting to the EU and their markets to provide an indication of the potential effects of free trade area between the EU and these countries. At the same time, various forms of contingent protection, such as anti-dumping and safeguard actions and the like from the array of policy instruments of the EU *vis-à-vis* third countries are all having a perceptible adverse economic impact.

The EU is by far the most important trade partner of Russia. It accounts for around 40 per cent of Russia's foreign trade. The figure will climb to over 50 per cent after enlargement. Indeed, enlargement will be highly beneficial specifically to Russia as it means that the acceding countries must lower their tariffs and to abolish quantitative restrictions. On the one hand, the dynamic effects of the enlargement process will benefit Russia. On the other hand, it seems very likely that EU enlargement creates a large trade diversion effects for Russia's trade. With prospects of 10 CEECs quasi-deflecting – which otherwise could be the major outlets for a stable Russian economy – there are poor prospects for Russia's export firms to strongly raise the exports volume of industrial goods – unless there would be an EU-Russian FTA (Welfens, 1999). Which tendency will be dominant in the near feature is dependent on the change in trade policies both in Russia and the EU as well as on the structure of trade flows between two partners.

Russia is a major exporter of energy and semi-finished products (e.g. metals and chemicals) prone to rapid and unpredictable price fluctuations. In spite of this, the structure of exports will remain the same for the near future. Due to its structure, Russian exports face generally low tariff barriers. Thus, Russian trade policy has concentrated on anti-dumping measures aimed at Russian producers. The picture on the import side is more blurred. It is extremely difficult to assess how much domestic production can compensate for imports.

Regarding FTA options between the EU and Russia are rather sceptical since minimising trade distortions would require concluding an agreement between all CIS countries and the EU on the one hand, and on the other hand reducing the relatively high Russian tariffs. However, there is the benefit of institutional stabilisation relevant to all trading partners after the conclusion of an EU-Russian FTA.

One straightforward opinion to integrate Russia into the world economy and to increase the overall effectiveness of governance in Russia would be WTO-membership in combination with a Customs Union EU-Russia. The experience of the customs union EU-Turkey is rather illustrative in this case. In 1996 Turkey introduced the EU-common external tariff and later brought some legislation into line with EU-rules (customs provisions, export credits, competition policy, state aid, intellectual property rights, standards and food hygiene). This case shows that such a customs union is not only stimulating trade but is also leading to more predictable tariffs and a better business climate. Exactly this is what Russia needs most. In addition to this, it is in line with comparative advantage and stimulate growth; in the first transition attempt Russia failed to generate rising intra-industry trade with the EU which is in contrast to the Visegrad countries - this is partly due to the lack of restructuring in the Russian economy.

The prospects for the integration of CEE with Western Europe depend on large measure in what becomes of Russia in the next few years. Integration with Western Europe through production networks, joint ventures, or FDI preclude the possibility of such business arrangements and bloc access to an enormous market. In the first half of the 1990s FDI has been principally market seeking, and has focused on food and beverages, cigarettes, consumer durables and cars as well as services. There has been the emergence of a new international division of labour in which Central Europe has come to feature in the locational production strategies of a number of Western companies.

At the same time, EU policies should be more active. The extension of the EU towards the East, with 'the corresponding expansion of the Single Market is a prospect for the various industrialists within the Union' (Balanya et al., 2000: 41). The main danger to East-West industrial co-operation is the concept of 'managed trade', which presupposes the availability and use of 'trade remedy' weapons in pursuit of the EU industrial policy objectives. With powerful transnational lobbying mechanism, application of contingent protection measures, such as safeguard clauses and anti-dumping measures is very unlikely to decrease (Widmaier & Potratz, 1999, p. 68).

Ultimately, it is the trade policies that shape the structure of national industry by encouraging or discouraging the development of industrial capacities. A trade creation effect results from the positive impact of economic growth in the EU area that is linked with the completion of the enlargement process. While this may be compensated to a certain extent by a trade diversion effect resulting from the increased competitiveness, the overall impact should nevertheless be positive.

- ✍ Enlargement and formation of production networks and nodes

On the part of the CIT, one has to consider the impact of the integration of substantial segments of these economies into the chains of international production interlinkages, or 'international production networks' (Zysman & Schwartz, 1998). In fact, Western firms have been busy setting up cross-border networks so that currently CEE firms are participating in EU-centred production hubs and have joined global corporate networks. For instance, in 1999, mergers and acquisitions involving international groups in the East totalled 17 bln USD, almost twice the figure of 1998 (Cecchini, Jones & Lorentzen, 2001: 161).

The picture of vertical product differentiation points to international hierarchies in production conditions. There are a number of tendencies in FDI developments in CIT, which support the arguments made above. First, there are clear gaps in CEE's production capabilities and, also, gaps in catering for domestic demand structures once these could be expressed more freely in the market after transition. The closure of these gaps through FDI activities and cross-border corporate integration is an important factor explaining early patterns of FDI. Second, the presence of foreign enterprises, through FDI, joint ventures and OPT activities, plays an important role in the upward movement within the vertically differentiated structure of East-West production and trade relationships.

The cumulative evidence of development in transition economies indicates the great importance of geographical location: the CEE economies adjacent to Western Europe absorb a much greater amount of FDI than those which are geographically (and culturally) removed. All these are important factors for embarking upon a catching-up process. Catching-up economies, particularly those with very strong gaps in capability structures, are operating in different technological and organisational environments and, furthermore, are catering largely to different ‘quality segments’ of international product markets than are the more advanced western European producers. Over time, as catching up gains momentum and as the linkages of cross-border corporate integration thicken, the strong quality segmentation gets reduced and a wider range of products become ‘competing products’. Potentially, such countries as Belarus, Russia or Ukraine could become attractive terrains for foreign investors to deploy some of their production activities.

There are two contrasting scenarios, related to the ways in transition economies could be used. First, it is the least cost production strategy, which consists of moving existing production arrangements to a lower-wage location, what involves relatively little effort to plan and prepare. It is a simple deployment, what would lead to a developmental scenario, in which a transition economy becomes low-wage, low-cost economy, that is, ‘maquiladorisation’ effect of low-wage factories and little value-added production. These strategies were pursued in the course of OPT arrangements in such countries as Rumania and Bulgaria, and are planned to be implanted in Belarus by the some large Russian companies, particularly in food, beverages along with the German and Italian producers in agriculture, timber and construction industries.

An alternative path is the complementary production strategy, that is, organisation of low-cost skilled work to create distinctive industrial capacities. The developmental strategy involves the transfer of significant technological capabilities to host countries. Inter-firm linkages create a trajectory that allows local subsidiaries and locally owned suppliers to move up the value added production chain would result in economic dynamism and beneficial spillovers for host countries. There is already some empirical evidence in support of this argument. As a result of more planned activities of European and global TNC, the Czech Republic, Hungary, Poland, Slovakia and Slovenia now have an internationally competitive automotive supply industry, and Hungary and Estonia an emerging information technology industry (Dyker, 1999). However, there is still great uncertainty about the longer-term characteristics of east-west European integration. These characteristics depend particularly upon the extent, speed and nature of catching-up processes of the CIT.

- ✍ Industrial implications of enlargement

Collins & Rodrik (1991: 76-80) attempted to estimate how much investment would be required for a ‘full catching-up’ which could involve a complete modernisation of the capital stock of the fSU to close the gap between their levels of labour productivity and the average of the industrialised West. They estimated that the level of existing capital stock in the fSU to be 1.7 trillion USD and that it would need to grow sevenfold to reach Western levels of capital per head over a decade which would require investment of 1.2 trillion per annum. They also estimated that the level of investment that would be required to generate a rate of growth of 7 per cent per annum in the fSU, which would be comparable to that achieved by the newly industrialising countries (NICs) of Southeast Asia as an alternative to the 'full catch-up scenario'. Authors found that it would require investment of 571 billion per year to achieve this objective through the Soviet Union.

With the completion of EU enlargement, level of protection for some sectors will be reduced while increasing them for others, what might be perceived as a jolt to the continent-wide economic equilibrium. The phenomenon will be reinforced by the intensification of competition within an enlarged EU, what essentially implies almost the same for the former Soviet Union (fSU) republics. This could be explored by using less conventional paradigms, of which an International Production Networks approach (Zysman & Schwartz, 1998) is one of the most appropriate. Production networks, developing as a result of international integration via foreign investment, that already have emerged in Central and Eastern Europe as a result of EU enlargement could potentially reach still further eastwards. Such business networks would benefit former Soviet citizens and provide a market for nearly 300 million more consumers for the rest of Europe. At the same time, what transpires in the fSU in the next phase would significantly affect the prospects for Central and East Europe's prosperity. If Russia and its neighbours - including Belarus - realise that their economic potential, a rich area of trade and production networks could develop. In this sense preferential trade agreement might be a useful tool. The EU signed Partnership and Co-operation Agreements with all of the republics comprising the CIS. The inclusion of an article in the Partnership and Co-operation Agreements explicitly mentioning the possibility of formation of a free trade area between the EU and the respective CIS republic reflects the fact that both sides have some interests in this project.

The potential for and speed of catching up is relatively high in all CIT, including Belarus and Russia precisely because of the inherited unbalanced nature of assets such as good stock of engineered skills, but insufficient capabilities in design, marketing, communication infrastructure, etc. Closing the existing gaps in skills and infrastructure, as well as in organisational and institutional structures, could thus lead to strong, positive externalities.

Non-associated states must recognise the necessity of developing coherent strategies for responding the shifting imperatives of industrial competition in the context of EU enlargement. If they fail to recognise the importance and to seize the viable opportunity to build effective production networks, it might create enormous political and economic difficulties in the future. 'Perhaps as firms in CEE begin to extend production networks further east, producers in Eastern Europe and the fSU may join in. Such a development would follow the examples of Korean and Taiwanese production networks, which have drawn third-tier countries into the regional industrial system. Until now the primary networks that have emerged in the fSU are survivalist or predatory rent-seeking arrangements (Huber & Worgotter, 1998) that too often take criminal form (Castells, 1998). Countries of the fSU need to fulfil the fundamental political and institutional requirements of market-driven economic growth. Ultimately, the fate of the CEE and fSU economies almost certainly will depend on the choices of their governments to provide infrastructure, skill development and above all, stable predictable and even enforced market rules.

State strategies in the context of EU enlargement

Rather than explaining differences in relative economic performance, which is the domain of conventional economics, political economy approach is more suitable to illustrate different paths of change in an economic order. What matters in political economy of transformation is not the question ‘Why does a country perform better or worse than its neighbour?’ but rather ‘Why did neighbouring countries make different choices with regard to the strategy of transformation?’
Regional scale is becoming a crucial dimension of productive, organisational and technological strategies in many industries. These mechanisms rely on shared economic and societal values, and the CIT should adopt them among themselves. Economy’s health often crucially depends on their constituent’s regions, or, in other words, the degree of embeddedness in flourishing regional economies. Investigating the impact of EU expansion on such countries as Belarus and Russia, we deal with two contrasting cases because of the size and policy priorities in these two countries. While Belarus represents almost a textbook example of a small open economy, Russia is the contrasting case.

- ✍ Small states’ adjustment: the case of Belarus

Small states –like Belarus is – are not able to pursue autonomous national development strategies (in comparison to East Asia). Contemporary international economics highlights that for small open economies outward orientation is the clue to sustaining economic progress against external disturbances. These countries are searching for answer from the point of view of price-takers, because their production entities cannot stand on their own. The case of European CIT is not an exception. The Eastern economies are not large enough to alter the overall development of the European economy (Baldwin, Francois & Portes, 1997). The critical issue then is how to participate in value chains of the advanced countries (Gereffi, 1997). In other words, they will need to insert themselves into a regional division of labour.

What can be learned from comparative analysis of the adaptive processes in different regions of the world economy, which could be policy relevant to these countries? Third-tier Asian development strategies provide a relevant analytical analogy for small countries in CEE, including Belarus. Third-tier Asian governments chose to integrate themselves into the production and marketing arrangements of the TNC rather than pursue semi-autarkic developmental strategies of Japan, Korea and Taiwan, coupled with heavy state intervention and promotion with trade protection. Basically, there are two impediments for such policies, namely the lack of rapid accumulation and the absence of a state capable of guiding the process of economic development. Moreover, the central causal arguments about the developmental state, notably nationalism and social mobilisation, has often been poorly understood by scholars working on East Asia and on industrial development and linking interventionism with rapid economic growth.

Belarus is directly an opposite case – the dominant characteristic of the ‘Belarusian path’ since independence has been the inability of the national idea to act as a form of articulation of an embryonic civil society. Belarusian society has not even undergone the initial stages of nationalist revival based on a new political identity and the mobilisation of the masses by reformist counter-elite. The roots of totalitarianism are particularly deep in Belarus, which suggests that it is more realistic to speak of contradictory and slow process of the development of civil society from below, rather than its revival. It is not a version of a developmental state, but rather a reversion to some of the worst aspects of the recently debunked Soviet state, including relentless harassment of the opposition and a determined attempt to restore both the planned economy and highly centralised executive control over the whole of society (Eke & Kuzio, 2000: 524). It is astonishing how the Belarusian economy resembles situation in Latin American countries in the 19th century.

'The interventionist and pervasively arbitrary nature of the institutional environment forced every enterprise, urban or rural, to operate in a highly politicised manner, using kinship networks, political influence, and the family prestige to gain privileged access to subsidised credit, to avoid various strategems for recruiting labour, to collect debts or enforce contracts, to evade taxes or circumvent the courts, and to defend or assert titles to lands. Success or failure in the economic arena always depended on the relationship of the producer with political authorities - local officials for arranging matters close at hand and the central government of the colony for sympathetic interpretations of the law and intervention at the local level when conditions required it. Small enterprise, excluded from the system of corporate privilege and political favours, was forced to operate in a permanent state of semi-clandestine, always at the margin of law, at the mercy of petty officials, never secure from arbitrary acts and never protected against the rights of those more powerful' (Coatsworth, 1978: 94, quoted in North, 1990).

It is argued that the domestic actors and institutions, or the particular class and social configuration across historical periods have played critical roles in economic development in Belarus. The resultant force of the lack of national self-awareness and the failure to re-evaluate recent history was the absence of ‘revolution of cadres’ in Belarus. The *nomenklatura* remained in power after 1991. Consequently, the development of national counter-elite was blocked and the consolidation of statehood during the crucial early years of independence was prevented. The core idea of Belarusian reform was statism as one of the best options, what essentially means the conservation of rent-seeking activity.

Olson’s (1982) application of interest group theory to problems of economic growth and stagnation can provide a useful insight on an important constraint in the generation of economic growth is deployed by distributional coalitions. These are interest groups, who try to change the income distribution to an increase in total income; distributional coalitions attempt to have a larger of a given quantity of welfare. In the case of Belarus, one can argue that transformation is politically dominated, and decision-making with regard to economic reforms is heavily interwoven with the configuration of political actors. This argument is made in conformity with institutional economics, analysing long-term evolutionary developments.

The amalgam of interests, existing at the post-soviet geo-political expanse cannot be easily dismantled because of the existence of entrenched interests. The main question today is pretty much similar to the operation of the developmental states, namely whether the denizens of this can successfully curtail their bureaucratic excesses to boost the international competitiveness of their industrial producers. Trimming some bureaucratic fat off the state does not mean the end of it; rather, it is a requirement for survival. Whether it can be done hangs in balance today, but those who have confidently dismissed the model may wake up one day to find East Asian states roaring back to prominence. The previous model should be changed, because the developmental model is first of all an attitude, an orientation, and only after a matter of technique, shifting the changing needs of the time.

✍ Options for large economies: the case of Russia

Russian case is rather unique among the post-socialist countries. The size of the country and its developmental path heritage, along with a dissimilar policy mix and social model are differing from those adopted by other CIT. There are two integral parts of the Russian transformation from a planned to a market economy, namely the privatisation (of the means of production) and the rapid development of the financial market.

'The Russian way' in privatisation was marked by a creation of disparities within society and catapulting of 'a small group of enterprising individuals into a position of power resulting from their economic standing' (Schröder, 1999: 962-963). 'Monetary overhang', which existed after the collapse of the USSR in the form of private savings, was not used to privatise the small entities on a large scale. Despite the fact that since the beginning of privatisation large companies were not included in this process, they appeared on the scene later through dubious auctioning. These companies emerged in part on the basis of the Soviet business structures, such as, for instance, branch bureaucracies (for example, the ministry of natural gas successfully turned into Gazprom). The ratings of the world-wide largest companies at the end of the 1990s included these 'newly emerged' Russian enterprises. Mainly, these were groups in oil and gas sector (Gazprom, YuKOS, LUKoil, NK Surgutneftegaz, Sibneft', Sidanko, Slavneft', Tatneft', Vostochnaya neftyanaya kompaniya), but also large energy producers (EES Rossii, Mosenergo) and companies in the telecommunication sector (Moskovskaya gorodskaya telefonnaya set', Rostelekom). Among the 10 credit institutions named in the list of the largest Russian banks that were smaller than the giant Sberbank, which – like Vneshtorgbank – was still state owned, but has developed a considerable level of activity.

In contrast to Russia, in the CEECs', the fates of small enterprises like shops, restaurants, small landholding, or farms wan never at issue, while the large-scale privatisation progressed slowly. In contrast to CEE, putting small business in the hands of self-interested private citizens has not gained a momentum in Russia. In CEE, encouraging small scale, private ownership also appeared likely to aid the growth of an entrepreneurial class and a capitalist ethics. At least, the early returns on these hypotheses have been promising. At the same time, a powerful critique of such reform path was raised by scholars working on East Asia (see Amsden et. al., 1994).

It was argued that the state should continue to play the major role in industrial development and remain the biggest owner of large industrial assets irrespective of the chosen privatisation strategy. Critique of liberal reforms was often based on the fact that state ownership makes sense at certain times, for instance, when markets are imperfect. This means that industries, which may hold long term economic potential or whose development may be in the national interest will never get off the ground. It followed the examples of Japan, South Korea and the Western industrialised states. 'There is the repeated history, in country after country where a sudden implosion of whole sets or sectors, results in the state finding itself forced to step in and nationalise the losers. Italy and Spain have lavish government portfolios so acquired' (Cohen & Schwartz, 1992). In Japan and Korea the giant industrial groupings that dominate the economy defy simple classification as either private or public (Amsden et al., 1994). Common to all these was the notion that economic development requires a state which can create and regulate the economic and political relationships that can support sustained industrialisation – or, in short, something similar to a developmental state.

In Russia, such reform propositions have been at least partially articulated. The formation of large business conglomerates which in the Russian and Western literature has been termed Financial Industrial Groups (FIGs), was a typical feature of Russia's market development. The logic was that only a few of the business groups would be able actually to solve the task of the restructuring of group enterprises as well as the acquisition of the necessary capital and its rational management. The evolution of such structures began in 1993, when the collapse of the administrative structures in charge of industry made space for new forms of production organisation. The auctioning of the most important companies since the mid-1994 and the creation of the legislature can be understood as the two basic factors contributed to the formation of FIGs, which were registered officially. At the same time a large number of holding companies and business conglomerates developed, especially around banks.

'The emergence of FIGs in Russia in the 1990s has been a result both of Soviet-era institutional legacies and of the difficult economic transition process. The traditionally close ties between enterprises and the state, the penchant for creating economic giants, the insider-dominated transactions, the bureaucratised corruption, and the importance of accumulating political power in order to yield economic clout all had their roots in Soviet times. These tendencies were exacerbated by Russia's traditional conditions, which allowed well-placed individuals to concentrate assets in their own hands in an atmosphere of uncertain property rights, an underdeveloped legal system, and poor investment conditions' (Johnson: 344ff).

According to Russian observers, these integrated structures were supposed to play a primary role in Russian economic policy or even to be an important instrument of economic policy as such. Western observers were more sceptical and interpreted the development of FIGs as a continuation of hybrid forms of Soviet economic organisation. The formation of financial industrial groups would have been unthinkable without the rapid development of the Russian banking sector, which began, with the reorganisation of the Soviet banking system in 1987.

Table 3: Development of the Banking Sector in Russia between 1991 and 1997

	1991	1992	1993	1994	1995	1996	1997
Number of registered credit institutions	1360	1713	2019	2517	2598	2601	2552
Number of active credit institutions				2457	2295	2030	1697
Number of credit institutions making losses		82	199	582	525	480	268
In %							
Number of registered credit institutions, increase		26	17,9	24,7	3,2	0,1	-1,88
Number of active credit institutions, increase					-6,6	-11,6	-16,4
Number of credit institutions making losses, increase		4,8	9,9	23,7	22,9	23,7	15,8

Source: Expert, 1997, 32: 33; 1998, 11: 2.

In general, financial sector is the tie that binds the state to the industrialists in the state.

‘The answers to [questions about financial resources] provide the best possible general insight into the direct and or indirect leverage a state is likely to have for realising any sort of goal it may pursue. For a state's could any other single factor about its existing (and its immediately potential) capacities to create or strengthen state organisations, to employ personnel, to co-opt political support, to subsidise economic enterprises, and to fund social programs" (Skockpol, 1982:6).

In Russia, the banking sector entered a transition phase during which the most successful institutions were those that used state resources and created a strong position for themselves in lucrative business areas such as the oil market. Apart from that, a number of banks started to build up networks of subsidiaries in order to participate in business with private clients and to offer financial services through the whole country. This change was accompanied by a concentration process – the number of active credit institutions decreased rapidly – and by consolidation process – the number of institutions making losses declined considerably – at least until the beginning of 1997. A number of banks acquired shares in large companies and became the core of a bank-led financial industrial group, nuclei of future financial empires. By 1995-96 the newly emerged business and financial groups had grown strong enough to become an economically and politically relevant factor (Schröder, 1999).

However, this type of interventionism in the market is necessarily Janus-faced. The state can achieve its goal by manipulating the financial structure, but once it does so, it has to be aware of the apparent policy errors, which has deeper causes than simply technical incompetence or the irrational goals imposed by the political rulers. Among these causes are the nature of interest groups and the nature of the state. The idea that the powerful interest groups constituted the real power in Russia was based on these two interrelated features, namely the rise of large business conglomerates combining financial institutions and industry and connected to this the rapid expansion of the banking sector during 1991-1997. This is reminiscent of the Dependency Theory, which regarded 'irrational' policies as the outcome of the manipulation of the state apparatus by the 'comprador' ruling elite. This provides a deeper insight at the subject rather than reducing the problem of development to that of accounting and balancing.

Ultimately, it could be argued that the Russian situation is not about the reform per se, but is more about the choosing of the model of development. The role of the state is more institutional rather than a Polanyian view of the state in economic restructuring. In Russia, the pioneers of the transformation had made very effort to create the conditions necessary for a functioning market economy, but they only passively accepted the processes of societal change that were precipitated. So, from that point of view, the restructuring of Russian society was more or less taking place spontaneously (Schröder: 1999: 958). On the other hand, transactions in the important sectors of the Russian economy were not mediated by the logic of the market, but carried out within the walls of bureaucratic hierarchies, or driven by ‘narrow interest’ concerns. This could be interpreted as that the constriction of social purpose was related to finance and class configuration of post-soviet Russia.

Class configurations, ideational constructs and policy choice

The reformist strategy (seen here as the type of economic reform pursued during the half-decade of the post-Soviet period) could be rethought in the light of competing scenarios of policy changes. The central force in this dynamics is the struggle between different fractions of capital, that is, closely linked with international markets 'comprador' sector of 'money capital' and more domestically bound 'productive capital', relying upon the support of conservative forces. In Russian context this means the conflict between 'monetarists' (i.e. neo-liberals, associated with 'money capital') and 'interventionists' (i.e. advocates of government intervention, associated with 'productive capital'), while in Belarus it is problematic to interpret the discourse over reform in terms of an ideational controversy.

According to Gramsci, organic intellectuals of the dominant social groups formulate and disseminate reformist ideas, transforming them into predominant ones in the policy discourse. Through their links to technocrats both in the government and branch industries and by occupation of specific positions in the institutional machinery, various actors (e.g. managerial cadres, party leaders, etc.) are well poised to obstruct or redirect the government's approach to reforming the economy. On the other hand, working potential of such cadres could be questioned. Emile Durkheim addresses these issues more broadly through the lenses of relationships between the individual and the state, and it seems to be a proper conceptualisation:
'Our political malaise is due to the same cause as our social malaise: that is, to the lack of secondary cadres to interpose between the individual and the state. We have seen that these secondary groups are essential if the State is not oppressing the individual: they are also necessary if the State is to be sufficiently free of the individual' (Durkheim, 1992).

In Russia, one of the explanations for this is the peculiar mode of privatisation that has been selected. After the collapse of state socialism, there had been a monetary overhang, which was not directed to privatisation so millions of potential proprietors simply lost their savings and did not become shopkeepers or farmers. Vouchers were bought for very low prices and used in privatisation of big resource-extracting enterprises. In addition, the crisis of 1998 also stopped the process of formation of so-called ‘middle class’. By now, the managerial element is either absorbed by big capital, tycoons, or dispersed among myriad of small economic units, which are often subjected to mafia control and bureaucratic arbitrariness. In similar fashion, Belarusian reforms have led to the embourgeiosement of the state administrative nomenklatura, the net result of which was the fusing of the nomenklatura and the amalgamation of it with the emergent entrepreneurial stratum. There is a business closely connected to bureaucracy and the state, and entrepreneurs, again, subjected to bureaucracy, with hardly anything in-between. Ultimately, this means the continuing polarisation of society, including, among other features, the growth of poverty. According to World Bank data the average poverty rate in Belarus has risen from about 5 percent to 25 percent during the last several years (IMF, 1999). There are similar figures for Russia could be found.

It could be argued that the erosion of the social system might in the long run render its constituents too narrow, and provoke the development of a coherent counter-movement for more inclusive and just societal order. By now, these contradictions have not led to the rise of the New Political Force able to articulate and implement a credible alternative strategy of reform. The salient feature of changes at the elite level of both Russia and Belarus is that these have been less wrenching that might have been expected, primarily because the old Soviet elite was not replaced, but rather reconfigured itself, expanding slightly to absorb new forces as circumstance dictated. The relevant conceptualisation here might be seen in the Gramsci’s idea of a passive revolution.

In general, the problem facing a state promoting development is not only that of identifying and moving to an optimal state in a given 'choice set' but also that of formulating 'choice set' itself. This means that there is an important ‘provision of a vision’ task in the role of the state. But what is necessary is to build a mechanism that will enable the state to put together and compare different visions that exist in the society and to create a consensus out of them. 'Consensus' should not be interpreted as an outcome of a harmonious decision-making process involving all relevant agents (Chang, 1999). In the case of Russia and Belarus, one has to deal not with the distinction but rather intimate proximity between public and private power. The continuing presence of a blurred distinction between the public and the private has guaranteed anaemic pattern of national integration into the global economy that benefits only a small proportion of population. In Belarus, the private and public domains are even more fused. Business interests are created by cronies with close contacts to the regime, which deliberately maintains the state control for the purpose of extracting resources. Such regimes are not interested in open and transparent market reforms or the growth of the private sectors because this would reduce state control over economy.

It could be argued that the successful insertion into European and global economy indeed depends on the managerial attitudes – to choose the direction of their work. An enlarged Europe might be seen as more stable and prosperous partner. Small business, intellectuals, academics, and journalists are the potential catalyst of change in society. These groups manifest autonomy and a cosmopolitan outlook that may allow them to step outside the confines of a country's failing economy and demoralised society ahead of the rest of the population.

Collective research work, called ‘Russia on the Edge of the Centuries’ (RIISNP, 2000) points out during the last decade Russian society evolved from the broad acceptance of the ‘Western’ development path and values towards accentuation of ‘own values’ and traditions as the motor of further development.

Table 4: The opinion dynamics on ‘strategic choice’ (‘traditionalism’ versus ‘Westernism’ dichotomy), per cent

The strategic choice for Russia	1993	1996	2001
Russia should search for its own way, alternative to the Western model of development (traditionalists)	44	52	46
Russia should work for integration with the West, getting rid of its ‘uniqueness’/’originality’	51	41	40
Hard to answer/Other opinions	5	6	14

Source: RIISNP, 2001: 8.

Another study, made by RIISNP in April 2001 (Independent Russian Institute of Social and National Issues), was aimed at discovering of mental maps of Russian elite (including deputies, ministerial clerks, academicians, analysts and journalists). The key factor of demarcation within elite is about the choice of the model of development: whether Russia should follow the Western path or to find it own alternative way? The survey demonstrates the similarity in the relationship between policy orientations both within elites and the public. In other words, both within the public and elites there are similar proportions of the advocates of ‘Western-oriented’ development and protagonists of the own and unique ‘third way’. The latter is not acquired the features of a comprehensive ideology, but rather entered to fill an ideological void, assuming the contours of the intellectually and emotionally empty space after the collapse of the Soviet Union.

There is a high degree of consensus concerning the socio-economic model of development – the majority supports the ‘mixed economic system’, which includes regulatory mechanisms of both the state and the market. Yet, the real demarcation of ‘expert society’ is a remaining dichotomy between ‘traditionalism’ and ‘westernism’.

Table 5: Strategic aims of Russia within 10-15 years, as proposed by 'traditionalists' and 'westerners', per cent

Aims	'Traditionalists'	'Westerners'
Come back to the 'super-state' status (like the USSR)	23,7	3,6
To be within 'top five' countries in the world	25,8	16,9
To be within a group of economically developed countries (like Spain, South Korea, Brazil)	24,7	32,5
To be the leader among the CIS states	4,1	6,0
To concentrate on internal rather than global issues	15,5	33,7
Other opinion	5,2	4,8
Hard to answer	1,0	2,4

Source: RIISNP, 2001: 16

About 65 per cent of Russian experts support the idea that Russia should establish closer ties and strategic partnership with the EU rather than the USA. It reflects so-called 'European vector' of the interests of Russian 'natural monopolies' (such as Gazprom, RAO, etc.). Despite this fact, only 17 per cent of experts think about Russia as a fully-fledged member of the EU (RIISPN, 2001: 17). Although the country is not ready to discuss the matter of membership in any case, in the longer perspective, Russia might meet membership requirements, not being a member. At the same time, the notion that Russia 'can be a normal European country with Russian characteristics' hardly translates into relevant policy actions or building of policy conditionality.

'Russians generally support a market economy, openness and democracy of some sort. Nevertheless, a lack of binding conditionality has tended to make policies captive to vested interests; rent-seeking and no-holds-barred struggles for power' (Sutela, 2000: 6).

In such situation, the EU might be a policy anchor for Russia. A similar precedent has been created with the re-affirmation of the membership prospects for Turkey. Vladimir Mau, one of the Russian policy experts, proposed that all national economic policies should be measured to facilitate a future membership in the EU. This idea also has been granted a support by Germany in April 2001, when the German Ambassador in Russia explicitly mentioned that in 20 or 30 year this 'should become a possibility' (BBC, April 12, 2001).

By now, Russian foreign policies were aimed at strengthening ties with the CIS countries by creation of smaller unions within the CIS (Customs Union of five countries, Belarusian-Russian Union). These unions were formed with greater enthusiasm and clearer need than was the CIS, but they seem to suffer from the same inability to create workable institutional bases of integration. Russian policy towards the CIS since 1992 has consciously modelled itself on the 'Monroe Doctrine' formerly pursued by the US in Central and Latin America and France in Africa. The CIS was defined by Russia during the first five years of post-Soviet rule as the 'Near Abroad', a term, which would seem to signify limited sovereignty and which suggests that the area lies within Russia's sphere of influence. Sergei Karaganov, head of the Russian Council on Foreign and Defence Policy, believes that the relationship between Russia and the CIS should be modelled upon that pursued by the US during the 1950s and 1960s in Central and Latin America:

'The CIS countries could serve as supplies of cheap labour and cheap goods to the Russian economy, creating a circle of dependent states around its perimeter, where Russia would play a dominant economic role' (Karaganov, 1999: 299).

In a way, such strategy was successful in the case of Belarusian-Russian economic integration. The overwhelming dependence on 'near-abroad' suppliers for components and markets for sale of the industrial goods meant that the economic survival of Belarus would depend on the resurrection of economic ties with the Russian Federation. Various integration initiatives (such as 'monetary union', 'confederation', or even 'federation') have been presented as a panacea for the country's economic woes. Indeed, after the break-up of the Soviet Union, the political and economic fortunes of Belarus have remained closely tied to Russia. Russia remains Belarus' largest trading partner, accounting for 52 per cent of exports and 67 per cent of imports during the first six months of 2001 (and approximately 80 per cent of Belarusian industrial goods are sold in the Russian Federation alone) (Statistical Bulletin, July 2001). Transport service revenues of close to 1 billion USD per year depend largely on the flow of goods between Russia and other countries. In addition, Russia's Gazprom is building a gas pipeline (Yamal) to Western Europe through Belarus. Investment in this pipeline accounts for more than half of Belarus' otherwise meagre for FDI. In such situation, it is hard to speak about this Union as a union of juridical equals. On the one hand, it is connected to the fact that no serious political actor in Russia, except liberals, ever advocated that the CIS as a whole could become a union of juridical equals, as the European Union is:

'The EU has two or three strong nations at its core, but it was Russia's intention that the CIS would have only one. Most influential Russians believed that the CIS states were incapable of sustaining independence, so membership in the CIS would be beneficial to all parties by minimising the hardship of transition in the new states, while helping to insulate Russia from its neighbours' problems' (Åslund et al, 1999).

On the other hand, Belarusian elites granted a support for such policy, except the small fraction of 'cultural nationalists' and isolated intelligentsia, which see the best future development in a long-term, methodical strategy of developing a renewed Belarusian national consciousness. But such a policy is likely to be unsuccessful without state support (in a manner similar to that provided in Ukraine). For the majority of the ruling elite as well as for the Russian-speaking liberal-democratic opposition, Russia remains a key partner. For state bureaucrats, the support of integration initiatives is like the 'building of socialism'. It might last for decades and finally end in absolutely nothing. Since independence the core idea of Belarusian reform path was statism for liberals and nomenklatura. For national opposition, it was an independent Belarus, purified from any external influences, while for nomenklatura it was a preservation of state influence over economy and polity. In the 'Conception of Belarusian statehood', developed by the president administration, there is basically strive to rid the state of everything nationally Belarusian and to replace it with very similar to that was Soviet Belarusian.

The growing liberal strand of the Belarusian opposition seeks a solution to the state's problems in market reforms, which enjoy priority over national revival. For them, Russia is liberally oriented Civic Party and independent Russian-language newspaper and journals have advanced such view most actively. But these ideas do not find fertile ground since there is no middle class or democratic political culture that would support such an approach in voting behaviour. Therefore, they have little potential for social mobilisation. In this case, one should expect that the current conjuncture does not have an immediate prospect for change, because of the mass political apathy, poverty and the lack of information, and, crucially, the absence of well-articulated progressive vision of reform and a political will to implement any progressive change. It will not probably be possible to gauge the coincidence and divergence of interests between post-soviet states as well as within these states until the present elite passes from the scene.

In the meantime, some of the former Soviet republics have demonstrated the ability to get lose of the predetermination of their 'Soviet endowments', and follow policies not constrained by momentary historic considerations. The story of the Baltics is one about the relevance of institutions and policies over endowments.

'There is a need to underscore the role of policies and institutions supporting spontaneous adjustment and limiting rent seeking, otherwise potentials and outcomes were bound to differ substantially. Conscious policies of institution building should support transformation process, which has to be dynamically efficient and self-sustaining. This finding could be supported by the analysis of transformation in the Baltic States: these countries would have seemed to be the most ill suited for independence in the globalising world economy. But if and when appropriate policies aimed at and actually delivering stabilisation, liberalisation and privatisation have been in practice. Their experience shows that the segregation from the previously unified Soviet economic space could be mastered, and institutions of the market economy could be put in place with reasonable success' (Csaba, 2000: 401).

This experience is the most relevant for Belarus in a sense that good institutions and good policies seem to work across the borders, irrespective of history and country size. Integration in the regional economy might be a complementary strategy, but not a substitute for internal reform. In the case of CIS, all the member states developed a complex set of motives for their policies towards the CIS, 'just as each has had to compensate for that organisation's failings in its own way' (Åslund et al, 1999). The viability of the Belarusian strategy towards the CIS and Russia has been jeopardised by the customs union with Russia, being a much larger country, could pursue a protectionist, inward-oriented policy more easily than Belarus, and could more easily bear the probable economic costs of such a strategy because of its rich endowment of natural resources.

Financial crisis in Russia produced negative spillovers for Belarusian economy. Belarus suffered economic repercussions through a decline in external demand and a contagion in the financial markets due to the rupture of the payment and settlement systems in Moscow. In general, economic activity slowed down substantially in the aftermath of the Russian crisis, with output growth falling from about 8.5 per cent in 1998 to 3.5 per cent in 1999 (IMF, 2000: 6). Both export and imports contracted substantially, resulting in a drop of the current account deficit from 6.1 per cent of GDP in 1998 to 2.2 per cent of GDP in 1999. Externally, exports to Russia, which accounted for more than 50 per cent of total exports, fell sharply during the second half of 1998, in the wake of the Russian crisis. Demand for Belarusian products was weak through 1999, showing signs of recovery only during the final quarter, with the revival of economic activity in Russia. Thus, such as inward-oriented strategy would very costly for Belarus. In contrast, a tariff-free trade area between Russia and Belarus is an excellent idea from the Belarusian perspective because it should give Belarus access to imported inputs at prices prevailing in the Russian market and it makes a much larger market available for Belarusian products. Whether or not Belarus will benefit depends, however, on the degree of tariff protection against third countries.

Given the current complex character of EU enlargement and formation of production of networks and nodes, one may argue that Belarus needs to avoid trading arrangements with the CIS that will, at the same time, discourage the development of improved trading relations with non-CIS markets. Trade with Western markets will offer Belarus access to the technology needed to upgrade design and production efficiency, and participation in the much more advanced 'value chains'. Learning to compete in non-CIS markets and co-operate with Western producers will thus provide Belarus the experience and expertise needed to remain competitive in its traditional markets.

For Russia, semi-autarkic policies might also be dangerous in the long run. The EU remains EU remains Russia's main trading and economic partner. In particular, Russia provides a significant part of the European Union's energy supplies. The European Union and Russia have a common interest in developing their energy policies in such a way as to improve the exploitation and management of resources and security of supplies in Russia and Europe. As for the EU, it is interested in Russian market with more than 200 million consumers. Germany and Sweden demonstrate strong interests in this respect.

Traditionally, Germany was the locomotive of European economic integration. The idea of European integration, and especially, in its monetary dimension is directly related to Germany. Currently Germany is the largest foreign investor for East-Central Europe, and also plays a leading role in financial assistance, foreign trade and FDI (Katzenstein, 1997). Moreover, all countries of the 'first wave' of accession (except Estonia) have their borders with Germany, or its German-speaking ally – Austria. At the moment, Germany expressed its commitment to support market reforms in Russia and promote the establishment of closer ties with the EU.

In its turn, Sweden has declared relations with Russia as a priority of its Presidency. Leif Pagotsky, Sweden's Minister for Foreign Trade and a central figure in Sweden's Presidency said that the EU needs a concrete long-term program for Russia's inclusion into European co-operation structures. He is pushing for Russia's gradual entrance into internal markets, with a possible fast tracking for Kaliningrad. In general, it is expected that the EU's relations with Russia will be further developed in the context of the Northern Dimension, as regards the environment and nuclear safety, the fights against international crime. The situation of Kaliningrad is of particular importance for both sides, but in this paper this theme is omitted. The Programme of the Swedish Presidency of the European Union has stated that:

‘The European Union and Russia both have an interest in enabling Russia to integrate into a Common Economic and Social Space in Europe…a high-level economic dialogue is considered as a tool to facilitate economic reform and integration…The International Financial Institutions (IFIs) should have a central role to play in the development of the Russian market economy by catalysing investments to viable projects in priority sectors. The [Swedish] Presidency will promote investments in Russia, including EIB financing of pilot projects with a clearly positive environmental impact and of mutual interests to the EU and Russia’ (CEC, 2001).

For these propositions to come into reality, relevant policy actions should be adopted on the Russian side. National markets for goods, services and even capital remain segmented from one another, leaving for governments considerable room for manoeuvre. The sustainability (or failure) of the respective reform policies is contingent upon success or the lack of it in terms of institution-building rather than on the endowments with raw materials or from degrees of previous integration to the Soviet economic space. This finding receives an in-depth empirical backing allowing for extending the conclusion to other transition countries. Therefore, the task is to design new institutions, build new coalitions and appropriate to an environment of rapid technological change and porous economic borders. The Enlargement of the EU, which will lead to a growing interdependence between the EU, Belarus and Russia, could be beneficial to all these actors, if the opportunities of the enlargement will be identified and adequate policy measures will be articulated and implemented.

Conclusion: formulating policy options

Two concrete possible implications might be drawn from the discussion above. First, non-accession countries could improve their economic performance by using trade opportunities and synchronising and catching-up with more advanced reformers via exploitation of growing heterogeneity in the region. These alternatives hold different implications for different countries with regard to socio-political developments in them. For Belarus and Russia, the alternative relates to the fact that an enlarged EU is very important economic and industrial power. The immediate neighbourhood produces an excellent 'window of opportunity' to reap off some benefits by establishing dispute-settlement mechanisms, investing and participating in ‘value chains’ of European corporations. For the EU, the alternative is related to those new market opportunities that arise from spatial proximity. Different conditions and social standards, on the other hand, provide a clue for utilisation of low labour costs' capacities.

In order to minimise the impact of unavoidable seclusion the scope of multilateral free trade should be expanded by creating a European Free Trade Zone from the Atlantic to the Pacific (thus englobing Russia). This argument is supported by the use of the gravity model of foreign trade. Indeed, the establishment of a free-trade area might be a 'building bloc', contributing to more decisive and large-scale continent-wide initiatives. However, such a proposition is potentially riddled with two antagonisms.

First, the fSU republics have attempted to maintain trade with each other through a variety of policy interventions, what could divert trade away from Europe and lock it in a kind of semi-autarkic integration grouping. However, the failure of the CIS due to the lack of truly market-driven forms of economic activity and market-promoting policies, might force governments to avoid such policies and facilitate integration (at least economic) of their economies into the EU. This step could compensate protracted restructuring and a resultant lack of foreign and domestic capital.

Second, there is the question of compatibility between regional integration, and a global one, what means, among other components, the WTO accession and membership. Moreover, the WTO membership may create the channel to pressurise the EU to remove barriers. That is why basically there is general support for the WTO's improved dispute settlement procedures, holding the promise of a build-up of more confined and predictable intervention by state policies than exists today.

Finally, although the regional integration facilitates the movement of goods, services, and investment and, to a lesser extent, people, it is not a process that simply crosses over regions. It is a process that emerges out of social relations that include identity, class and civil society. Civil society indeed provides a basic for challenge to the existing order by providing a tool by which the pluralism of social opinion can be articulated to the decision-making bodies. Therefore, an effective approach has to be marked by the extension of the rule of law and civil society across borders. In contrast to nations and blocs, identity cannot be based on the existence of the ‘other’; it has to be inclusive identity drawing on principles and practice of potentially universal application.

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